No. 16995

IN THE

# United States Court of Appeals

FOR THE NINTH CIRCUIT

---

Los Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr., and Stanley C. Marks,

*Appellants,*

*vs.*

Securities and Exchange Commission,

*Appellee.*

---

Appeal From an Order and Judgment of the United States District Court for the Southern District of California.

---

## APPELLANTS' PETITION FOR REHEARING.

---

Morgan Cuthbertson,
220 Park Avenue,
Laguna Beach, California,
*Attorney for Appellants and Petitioners.*



Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

## TOPICAL INDEX

PAGE

I.

O part of the opinion of the court, with respect to the statu-ry authority for this action, is inconsistent and conflict-g with another part of the opinion..... 2

II.

"e see no reason why the fact that the Securities Act estab-shes a right which an individual may enforce necessarily rips the SEC from having similar rights as a litigant"..... 3

III.

"e sale of any securities without the approval of the SEC, rovided they are sold in interstate commerce, or by use f the United States mails is per se unlawful"..... 4

IV.

Oy the United States Court of Appeals may try the suffi-ency of an affidavit charging bias and prejudice of a istrict court judge..... 5

V.

Ts court has overlooked the appellants' claim of prejudice rising from the denial by the district court of all discovery roceedings sought by appellants before trial..... 6

VI.

L'TD and David Farrell were denied legal representation uring an important part of the trial..... 7

VII.

B; and prejudice of the district court judge was established y the affidavit relating to the incident on April 21, 1960.... 10

PAGE

VIII.

Appellants believe the point of the James West evidence has been misconstrued by the court ..... 13

IX.

Who has been defrauded? ..... 14

X.

Appellants suggest this court may wish to strike a line from its opinion ..... 16

XI.

Is the trust deed business a promotion? ..... 18

XII.

In what securities are the appellants held to have traded? ..... 18

XIII.

There appears to be a conflict in the prescribed duties of the receiver ..... 19

XIV.

Should the February 17, 1959, opinion of this court be deemed to have been modified by this opinion? ..... 19

XV.

Did the court intend to exclude the appellants for all time from the exemptions from registration provided by both the Securities Act of 1933 and the Securities Exchange Act of 1934? ..... 20

XVI.

Has the court considered that its opinion approving the appointment of the receiver may be contrary to the ruling of the Supreme Court in Gordon v. Washington? ..... 23

PAGE

XVII.

T adjudication against the appellants was made before t: trial began . . ." ..... 26

XVIII.

Ar trary orders made on the whim or caprice of a trial judge, thout pleadings, or without evidence, should not be sus- ned on appeal ..... 26

Ap ndices:

pendix I. Copy of pages 2808 to 2811 of the Reporter's Transcript ..... App. p. 1

pendix II. Copy of pages 1656 and 1657 of the Reporter's Transcript ..... App. p. 4

# TABLE OF AUTHORITIES CITED

## Cases

PAGE

Connelly v. United States District Court, 191 F. 2d 692 ..... 5
Deckert v. Independent Shares Corp., 311 U. S. 282 ..... 2
Gladstein v. McLaughlin, 230 F. 2d 762 ..... 5
Goldman v. United States, 316 U. S. 129 ..... 31
Gordon v. Washington, 259 U. S. 30 ..... 25
Hillsborough Investment Co. v. SEC, 276 F. 2d 665 ..... 21
Jencks v. United States, 353 U. S. 657 ..... 31
Merger Mine v. Grismer, 137 F. 2d 335 ..... 5
Mitchell v. DeMario Jewelry Co., 361 U. S. 288 ..... 23
National Labor Relations Board v. Adhesive Products Corp., 258 F. 2d 403 ..... 31, 32
Porter v. Warner Holding Co., 328 U. S. 395 ..... 23
Roviaro v. United States, 353 U. S. 53 ..... 31
United States v. Reynolds, 345 U. S. 1 ..... 31

## Rules

Federal Rules of Civil Procedure, Rule 27 ..... 27
Federal Rules of Civil Procedure, Rule 34 ..... 27

## Statutes

Securities Act of 1933, Rule 122 ..... 30
Securities Act of 1933, Sec. 3 .....
Securities Act of 1933, Sec. 4 .....
Securities Act of 1933, Sec. 8(e) ..... 3
Securities Act of 1933, Sec. 20(a) ..... 3
Securities Act of 1933, Sec. 20(b) .....
Securities Act of 1933, Sec. 22(a) .....

PAGE

Securities Act of 1933, Sec. 23 ..... 4

Securities Exchange Act of 1934, Rule X-4 ..... 30

United States Code, Title 15, Sec. 77(c) ..... 4

United States Code, Title 15, Sec. 77(d) ..... 4

United States Code, Title 15, Sec. 77(w) ..... 4

United States Code, Title 15, Sec. 77t(b) ..... 2, 3, 4

United States Code, Title 15, Sec. 77v(a) ..... 2, 3

United States Code, Title 15, Sec. 77L(2) ..... 3

United States Code, Title 28, Sec. 2101(f) ..... 32

United States Code, Title 28, Sec. 144 ..... 5, 10

TEXTBOOK

Loss, Securities Regulations, p. 413 ..... 5

No. 16995

IN THE

# Jnited States Court of Appeals

FOR THE NINTH CIRCUIT

---

os Angeles Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Exchange, Trust Deed & Mortgage Markets, David Farrell, Oliver J. Farrell, Roy A. Bonner, Thomas Wolfe, Jr., and Stanley C. Marks,

*Appellants,*

*vs.*

ecurities and Exchange Commission,

*Appellee.*

---

ppeal From an Order and Judgment of the United States District Court for the Southern District of California.

---

## PPELLANTS' PETITION FOR REHEARING.

---

*o the Honorable Chief Judge Chambers, and to Judge Barnes and Judge Jertberg:*

The appellants respectfully petition the judges of this ourt for a rehearing of this appeal with respect to the inion and judgment of this Court dated November 3. 1960, for the following reasons:

## I.

### One Part of the Opinion of the Court, With Respect to the Statutory Authority for This Action, Is Inconsistent and Conflicting With Another Part of the Opinion.

On page 3 of the printed copy of the opinion appears the following:

> "The jurisdiction of the court below rests upon section 22(a) of the Securities Act of 193 *(15 USC 77v (a))* as to three counts and upon section 27 of the Securities Exchange Act of 193 *(15 USC 78 (a a))* as to two counts."

At the bottom of page 27 of the opinion the following appears:

> "Thus, we see that *15 USC 77t(b)* (and the substantially identical 21(e) of the Securities Exchange Act of 1934 *(15 USC 78u(e))* is the basis of the authority for the SEC's suit herein."

Thus it appears that on page 3 of its opinion this Court declares that this action was brought under 15 U. S. C. *77v(a)* of the Securities Act of 1933. On page 27 the opinion says the action was brought under 15 U. S. C. *77t(b)*.

The issue of which of these statutes authorized the action was vigorously contested. The appellant contended for 15 U. S. C. 77t(b). (Op. Br. p. 17.

Note that Section 77t(b) confers express autority on the SEC, while Section 77v(a) does not mention the SEC at all. The Supreme Court of the United States in the case of *Deckert v. Independent Shares Corp.*, 311 U. S. 282, cited on page 30 of this Court's

nion, holds that 77*v*(a) was the appropriate author- for the action brought by an investor under the l liability provisions of Section 77 *L*(2).

II.

**"We See No Reason Why the Fact That the Securities Act Establishes a Right Which an Individual May Enforce Necessarily Strips the SEC From Having Similar Rights as a Litigant."**

The foregoing is a quotation from page 30 of this Court's opinion.

Would this Court accept as a reason that Congress s a difference and a distinction? Congress enacted Section 20(b) (15 U. S. C. 77t(b)) to provide for at it considered as being appropriate for the powers ich it prescribed for the regulatory functions of the .C. and enacted Section 22(a) (15 U. S. C. 77v(a)) other remedies which it thought appropriate for a timized stock purchaser who might have to contend h agile and ingenious defendants to get his money k?

There can be no doubt that Congress carefully pro- ed separate remedies for each, possibly for the reason t it did not want the SEC to be in competition with bankruptcy court.

We also doubt that Congress intended the Securities Exchange Commission to act as a talent scout and vance agent for the bankruptcy court and to under- e to punish possible violators of the Securities Act having receivers drag them to the door of the bankptcy court, and there to wait until a group of credits might undertake to open the door. Punishment was

specifically made a function of the Attorney Gene l by 15 U. S. C. 77t(b). Congress, presumably, had reason for this also.

Is it not reasonable to assume that these may have also been the reasons why Congress recently refu d to expand the remedies requested by the SEC, as dis ssed in Appendix XI of our opening brief?

## III.

## "The Sale of Any Securities Without the Approval of the SEC, Provided They Are Sold in Interstate Commerce, or by Use of the United States Mails Is Per Se Unlawful."

The above sentence, appearing at the middle o page 28 of this Court's opinion, was not the law until was promulgated and declared on November 23, 1960 this Court. The SEC is not authorized by the Securities Act either to *approve* or *disapprove* the sale of a y security. To the contrary, Section 23 of the Securities *Act* (*15 U. S. C. 77*(w)) provides that it shal be a criminal offense to allege that the SEC has passe upon the merits of or has given approval to any securit

Section 3 of the Securities Act (15 U. S. C. 7 (c)) lists 11 classes of securities which are exempte and over which the SEC has no jurisdiction.

Section 4 of the Securities Act (15 U. S. C. 7 (d)) lists various transactions in securities which a ex-empted from registration under the Act.

Each of these exemptions are automatic. It not necessary to ask the SEC to grant or concede t ex-

...tion if the facts of a case bring it within an exemp-...on. (See "Securities Regulations" by Louis Loss, ... 13. *Merger Mines v. Grismer,* 137 F. 2d 335, 342.)

## IV.

## Only the United States Court of Appeals May Try the Sufficiency of an Affidavit Charging Bias and Prejudice of a District Court Judge.

...he last complete paragraph at the bottom of page 15 of the Court's opinion, when it states that upon the fil...g with a district court judge of an affidavit charg-...him with bias and prejudice, the rules of court, or the case law, or the canons of judicial ethics require hi... to file counter affidavits with the presiding judge of... court to determine the matter of his qualifications, w... not the law until it was promulgated by this Court's op...ion.

...ection 144 of Title 28 of the U. S. Code, the stat-...authorizing the affidavit, makes no such provision. Th... only place where the affidavit of bias or prejudice ... be tested is in an appropriate proceeding before the Uited States Court of Appeals. The rules of court, so ...as we can determine, are silent on the subject. The ...ions of judicial ethics which we have found do not ...e with the subject. The case law only seems to ...orize the proceeding before the appellate court. (*Connelly v. United States District Court,* 191 F. 2d ... *Gladstein v. McLaughlin,* 230 F. 2d 762.) No ... counter-affidavit was filed with the presiding ju...e, nor did he act in the matter.

## V.

## This Court Has Overlooked the Appellants' Claim of Prejudice Arising From the Denial by the District Court of All Discovery Proceedings Sought by Appellants Before Trial.

This subject was presented in detail commencing on page 34 of our opening brief, and was again presented for consideration on page 17 of our reply brief. We repeat here our summary as appearing in the reply brief:

"Prejudicial Denial of Discovery to Appellants.

"On page 35 of our Opening Brief we asserted the district court had committed prejudicial error on June 10, 1959, in quashing subpoenas re depositions which had been issued to SEC investigators Burr and Rheinschild. On page 35 of our brief we claimed prejudicial error with respect to subpoenas re depositions which had been issued by the District Court for the District of Columbia to Philip A. Loomis, Jr. and other SEC agents in Washington, D. C. With respect to the District of Columbia depositions, the Honorable Thrmond Clarke issued a stay order on June 12 [R.-78 without any evidence whatever to support it, and in the absence of any request for such a stay. On June 23 the district court issued an order quashing those subpoenas [R-115] in the absence of any evidence or showing by the SEC of any impropriety in connection with those planned depositions, and in complete disregard of two affidavits filed by the appellants outlining the information sought to be developed and the importance of that information to the appellants' case. (See Defendants' Response to Rule and Order to Show Cause, verified by

David Farrell [R-89], and Affidavit of Morgan Cuthbertson [R-110].)

"The SEC cannot contradict or deny this record. It lamely seeks to justify these outrageous orders, commencing on page 64 of its brief, by saying that the subsequent conduct of the appellants on July 6, when appellants advised the SEC to seek a more definitive order if it desired to expand its marathon fishing expedition, and appellants alleged misconduct during the trial, which commenced on October 6, made proper these various orders of June 10, June 12 and June 23 by which the appellants' discovery rights were summarily denied."

We direct the Court's attention to Paragraph XVIII of this petition *infra*, page 25, where under a different heading there is a further discussion of the record related to these matters.

## VI.

## LTD and David Farrell Were Denied Legal Representation During an Important Part of the Trial.

On pages 20, 21 and 22 of its opinion this Court discusses the proceedings in the district court on October 5, 7, 8 and 13. On page 20 (lower of middle page) the opinion of this Court reads in part as follows, with reference to the district court order of October 5:

". . . it ordered certain facts urged by the SEC 'to be taken as established'; it forbade *appellants* 'to oppose, by introduction of testimony *or otherwise*, the claims of the SEC' . . ." (Emphasis supplied).

This is not the way the order read. The "gag" order applied only to LATD and David Farrell. It did not apply to the other appellants. (A copy of the order appears at p. 44 of our Op. Br.)

Mr. Cuthbertson was under no restrictions with respect to his other clients, and Mr. Foley was under no restrictions with respect to his client TD&ME. For this reason the transcript shows active participation on the part of both counsel, but only on the part of those defendants who were not subject to the "gag" order.

What sort of representation is it if counsel for a defendant is forbidden to oppose the claims of the adversary by "testimony or otherwise"?

What documents may have been identified on cross-examination and offered in evidence on behalf of Farrell and LATD but for this prejudicial order?

Is it any consolation to a litigant, denied effective counsel, to be told that his co-defendants may have been well represented?

Can the court say with any assurance what counsel for LATD and David Farrell may have felt necessary to say or do on behalf of these defendants if they had not been prohibited from saying or doing anything on their behalf?

We hold it to be a radical and dangerous precedent supported by no authority which has come to our attention, that a defendant may be denied counsel, and then be told he has suffered no prejudice because there was nothing his counsel may have said on his behalf that was not said by counsel for other defendants.

This court is mistaken in its reference to the record

At the middle of page 21 of its opinion, and again at the middle of page 22, this Court asserts that the appellants requested the trial judge and obtained a suspension of trial until they could apply to the appellate court for a writ. This is not true. The trial judge had no knowledge that the appellants were preparing an application for a writ. [See Rep. Tr. pp. 294-298.] It was the SEC, not the appellants, on October 13, which requested the trial be suspended to permit an appearance to be made before the appellate court on the following day. [Rep. Tr. p. 298.]

The belated corrective order of the district court on October 22, mentioned at the bottom of page 20, does not demonstrate an absence of bias and prejudice, as assumed by this Court. This order was made pursuant to the earlier mandate of the appellate court of October 1 wherein it was said ". . . there is a strong misunderstanding between court" (trial court) "and counsel as to the existence of a proper order for discovery that which calm reflection and discussion in open court would, in all probability, dispel."

Judge Stephens, during the argument before the court, suggested the motion from which this order followed.

On page 22 the Court again discussed this "gag" order. The second sentence of paragraph (G) reads:

> "If such a specific order was made, it was apparently never enforced."

If by this the Court means that counsel were not punished for contempt in refusing to comply with the order, then it may be said the order was not enforced. Counsel were so frequently threatened with punishment for contempt during the trial that disobedience of such

an order would most probably have been followed with an immediate contempt citation. Thus it may have been "enforced."

## VII.

## Bias and Prejudice of the District Court Judge Was Established by the Affidavit Relating to the Incident on April 21, 1960.

The opinion of this court with respect to the affidavit relating to the incident of April 21, 1960 in the chambers of the district court judge, appearing on page 16 of that opinion, does not fairly evaluate or report the contents of that affidavit. The affidavit contains a much more serious breach of judicial decorum than is indicated by the comments of this Court. The affidavit, having been considered on two occasions by this Court, the appellants ask that the order of July 14, 1959, sealing that document, be revoked so that it may be considered evidence in this case.

This Court makes a point that "no new *motion* to disqualify the trial judge" (emphasis supplied) was made in the district court. This was admittedly near the end of the trial. What opportunity was there to make a *motion,* to whom might it have been made? What statute or rule authorizes a *motion* to disqualify a judge? We know of no proceeding except the filing of an affidavit as authorized by 28 U. S. C. 144. This Court ruled, in its order of October 16, 1959, that an order by a district court judge rejecting the claim of bias and prejudice was not an appealable order, so no motion could have been made to the appellate court.

This Court refers to the incident as being an informal conference in chambers. The persons who were

nsent and the nature of the proceeding made the ses- n far from informal. The purpose was to subject ppellants' counsel to pressure so that essential rights the defendants might be waived. It was a 20th cen- ry star-chamber proceeding.

This Court concludes, that from the episode it can- n say that the occurrence prevented a fair trial to ap- ants in view of the "plethora of evidence" which ity generally supports the Court's findings.

t would appear that the reasoning of this Court is t if the evidence appears to support the findings of a district court judge, the appellate court will sustain the judgment even though it may be conceded that the trial judge was biased and prejudiced against the person against whom the judgment ran. We do not believe t this was the law until it was announced by this Court.

This Court will be reminded of its Per Curiam opin- o of July 14, 1960, wherein the affidavit relating to th incident on April 21, 1960 was evaluated. The lat- e part of that opinion referred to the participation of two district court judges, one being designated as Judge "A" and the other being designated as Judge "B."

The concluding sentence of this opinion of July 14, 1960 reads:

> "Inasmuch as the case does not appear to be with Judge 'A,' we shall now take notice of the three page affidavit only to the extent of ordering it sealed up, to be unsealed only on order of this court."

The judges of the Court of Appeals will be interested to know that Judge "A," the Honorable Thurmond

Clarke, has again assumed full control of this case and of four collateral actions which have grown out of it, by way of transfers from several other district court judges to whom the matters were initially assigned.

Judge Clarke is now acting as judge of all matters relating to the case of SEC versus Los Angeles Trust Deed & Mortgage Exchange, from which this appeal was taken, and as judge of the following related matters:

(1) An involuntary petition in bankruptcy against LATD, originally assigned to Judge Crocker, and wherein LATD has responded by a petition for reorganization under Chapter XI of the Bankruptcy Act.

(2) An action by eleven customers of LATD seeking the appointment of a receiver and damages from LATD and other appellants of some $20,000,000, the action being entitled "Charles E. Smith, et al. v. LATD &ME, et al., and bearing number 1129-60. This case was originally assigned to Judge Westover."

(3) An action instituted by Pat A. McCormick as receiver against David Farrell, and other defendants, seeking the recovery of money and assets claimed to be in excess of $400,000. This case bears number 056-60. It was originally assigned to Judge Byrne.

(4) The petition of Arthur Young & Co., for fees in the sum of $37,769.00 for accounting services allegedly performed since June 8, 1960 for and on account of the receiver, which employment was originally authorized by Judge Mathes, and to him the petition was initially addressed.

Did the judges of the Court of Appeals contemplate that this situation might eventuate from its order?

## VIII.

## Appellants Believe the Point of the James West Evidence Has Been Misconstrued by the Court.

On page 24 of its opinion, this Court discusses the evidence with reference to James West, and comes to the conclusion that the error of the trial court in the instance noted was not prejudicial error. The opinion in this respect indicates that the question propounded to the witness may have been "clearly inadmissible on any ground whether urged or not. . . ."

The question, the objection, and the ruling, are set forth on page 24 of the opinion.

This, of course, was cross-examination. The witness on his direct examination had identified the brochure which he said he had received before he had entered into any transaction with the appellants. [Rep. Tr. p. 232, line 23.] He admitted that he had read it. [Rep. Tr. p. 264, line 15.] He admitted that the contents of the brochure "was pretty much in line" and "harmonious" with what had been told to him by Mr. Stark. [Rep. Tr. p. 265, line 2.] The brochure stated emphatically the company would not pay interest. The issue involved in the question was, was the witness justified in believing that the company would pay him interest. That was his contention given on direct examination.

Upon this review of the record, this Court may wish to modify its opinion in this respect.

We do not belabor this point on any contention that this in itself as a ruling on evidence, constitutes reversible error. We presented the occurrence in our brief to show another of the many incidents of bias and prejudice, and that this customer (the only customer produced by the SEC as a witness) was not relying upon

the appellants to make his purchase profitable, either solely, or at all, and thus the second essential element of an investment contract was conspicuously missing.

This court in its opinion has this comment (p. 4):

> "Perhaps counsel for the SEC would have raised such a ground, had he not been interrupted by the court's ruling in his favor."

This we suggest is an unwarranted speculation. We believe it does contain a recognition of the bias and prejudice of the trial court. The bias and prejudice is not shown by the ruling, erroneous as that may have been. It is shown by the disposition, repeated so many times in this case, to jump the gun in favor of the government agency, and to give little or no consideration to the rights of the appellants.

## IX.
## Who Has Been Defrauded?

This Court, on page 28, middle of the page, of its opinion, concludes that the evidence supports the trial court's finding that the appellants were guilty of "deceitful and fraudulent acts." There is no reference at this point to the record. At the bottom of page 28 this court observes: "It is unnecessary to mention again the various badges of fraud and deceit previously touched upon in this opinion."

We have gone through the opinion with a fine toothed comb and can find a reference to no one who has offered competent evidence that he had been defrauded. Can it be said that there can be fraud in the abstract with no person actually having been defrauded? We assume the court may have had reference to the so-called "windfall" evidence, alluded to commencing on page 9,

the practice, approved by certified public accountants as being in accordance with established accounting principles, of evaluating trust deeds bought back from customers at the price paid to said customers, mentioned on page 28.

With reference to the "windfall profits," the Court has copied in the margin of page 11, in support of its opinion, the findings of fact of the district court, reading in part:

> "6. The entire sequence of events in which LATD sought to appropriate the 'windfall' profits belonging to investors, in callous disregard of their legal and moral obligations to such investors, is elaborately set forth in schedule (PX 77) *the* accuracy *of which is admitted by the defendants.*" (Emphasis supplied.)

We have published as Appendix I to this brief, pages 2808 to 2811 of the Reporter's Transcript, which reports the specific and detailed designation of errors made at the time this Exhibit PX 77 was offered and received in evidence, and the admissions by counsel for the SEC that the document was not even warranted by the SEC as being accurate. We also publish as Appendix II, pages 1656 and 1657 of the Reporter's Transcript containing the undisputed evidence there was no pay-off or windfall in connection with these transactions, and that the earlier report of a pay-off was found to be in error and was withdrawn.

PX 77 was a self-serving compilation of conclusions of fact and conclusions of law prepared by SEC investigators. It should not have been received in evidence. It is a weak reed upon which to base so important an issue as fraud.

Concerning the valuation of trust deeds re-purchased from customers, it was the undisputed testimony of an impartial C. P. A. expert Mr. Edwin Russ, that proper accounting practice required that such trust deeds be valued at the price paid to the customer. [Rep. Tr. p. 3235, line 21.] He repeated on cross-examination [p. 3251] that this was in accordance with established accounting principles. There is nothing to contradict this testimony. In the face of this evidence, is there anything, other than speculation to support this court's conclusion (bottom of p. 28), that this accounting method resulted in a ". . . *fraudulent* evaluation of the appellants' assets?" (Emphasis supplied.)

We would have no objection to the word "erroneous" or "mistaken" if the witness was found to be wrong. The word "fraudulent" we respectfully contend is neither justified nor supported by the record.

## X.

## Appellants Suggest This Court May Wish to Strike a Line From Its Opinion.

Appellants suggest the Court may wish to strike that sentence appearing near the bottom of page 17 of its opinion reading: "He should have been."

This line may be construed as an official reprimand. We do not believe this Court would wish to reprimand counsel for any litigant in the absence of any evidence bearing on the conduct for which the reprimand is offered. The record shows that a whispered communication between one defense counsel to another defense

counsel was overheard by the court. (See Appendix V p. 1 of our Op. Br.)

The reporter apparently did not hear the communication. At least he did not report it.

No objection or comment was made by counsel for the plaintiff or by anyone else.

The record does not disclose what was said. The record does show that the judge was demonstrating hostility to the witness and to both defense counsel. The attorney for the SEC had just interrupted the cross-examination of the comptroller for LATD, who had been called by the SEC. The interruption was in the form of an objection to a question which had been proposed by Mr. Foley. [Rep. Tr. p. 752.] The objection was not based upon legal grounds, but sarcastically sought to belittle and discredit the witness. The witness sought protection from the court. He declared: [Rep. Tr. p. 753, line 26] "I take that as a personal insult."

What he got from the court was a scolding and the heat of a fine.

Mr. Cuthbertson, startled at the unwarranted explosion from the bench, mumbled that he was "sorry" to have triggered the judicial explosion. It was one of those polite things that a person may say when someone suddenly claims to have been offended.

Mr. Cuthbertson considers that what he said was necessary and appropriate at that time to the proper representation of his clients.

If the appellate court wishes to condemn without knowledge of the act which it condemns, it has the unquestioned right but we doubt it would wish to do so.

## XI.

## Is the Trust Deed Business a Promotion

The Court has needlessly offended and discredited the very considerable trust deed business by referring to it as a "promotion."

At the bottom of page 31 of its opinion, this Court refers to the business of the appellants as being ' . . . a business the very essence of which is promotion.'

## XII.

## In What Securities Are the Appellants Held to Have Traded?

The opinion of this Court, in the last sentence, affirms the judgment of the District Court. That judgment holds the appellants have been dealing in these securities [Judgment p. 2, line 23]:

> ". . . evidence of indebtedness, investment contracts or receipts for or guarantees of such securities . . . or any other securities, including trust deed or mortgage notes or other evidence of indebtedness created, issued or acquired by said defendants in connection with any investment plan, program or arrangement. . . ."

The opinion of this Court, however (p. 27), expressly finds only that the defendants have been dealing in ". . . the equivalent of an investment contract."

The opinion of this Court and the judgment of the District Court as so affirmed appears to be inconsistent and conflicting in this respect.

## XIII.

## There Appears to Be a Conflict in the Prescribed Duties of the Receiver.

There is an apparent conflict and inconsistency between that portion of the Court's opinion, which on page 7 concludes that the receivership should be considered *pendente lite* and which may be subject to release upon showing the appellants have complied with the registration provisions of the Acts of Congress, and that portion of the district court's judgment, affirmed by this court, which on page 11, lines 3, 4 and 5, directs the receiver ". . . to determine, adjust and protect the equities of thousands of investors whose savings have been entrusted to Los Angeles Trust Deed & Mortgage Exchange and Trust Deed & Markets."

## XIV.

## Should the February 17, 1959 Opinion of This Court Be Deemed to Have Been Modified by This Opinion?

We do not find in the opinion of the Court the element of *sole reliance* as an essential element of an investment contract, nor any finding by this Court that the customers of LATD relied solely upon the efforts of that company. Should a reader of this opinion conclude that this court is modifying its earlier opinion re-

ported in 264 F. 2d 199, where at page 212 it declared that sole reliance upon the promoter or others was an essential element of an investment contract?

XV.

**Did the Court Intend to Exclude the Appellants for All Time From the Exemptions From Registration Provided by Both the Securities Act of 1933 and the Securities Exchange Act of 1934?**

On page 31 of the opinion, this Court stated:

> "Obviously, on motion of the appellants the District Court should not release the appellants from the receivership until they have complied with the registration provisions of the Acts of Congress which they have offended."

The prayer of the SEC complaint prayed that the injunction should not apply to exempt securities or exempt transactions. [Appellants' Record p. 30].

The SEC brief (pp. 50-51) concedes: "We do not contend that all of the trust deed notes sold by appellants, as distinguished from the investment contracts of which they form a part, are necessarily subject to registration."

The Court may have overlooked that the appellants claimed exemption from registration in their Second Affirmative Defense of their answer [R. 50] and made this one of the issues of their appeal. (Op. Br. 15 and App. VII.)

(1) Under the Provision of the Securities Act of 1933 the Appellants Would Be Exempted From Registration, Which Exemption Would Be Effective by Operation of Law and Which Does Not Require Any Ruling, Determination, or Adjudication by the SEC. Section 3(a)(11) of the Securities Act of 1933 (15 U. S. C. 77c(a)(11)) Provides an Exemption for Any Security Offered and Sold Only to Persons Residing in the State Where the Issuer Has Its Residence and Principal Place of Business.

The record is uncontradicted that since August 1, 1959 LATD has made offerings and sales of trust deeds exclusively to residents of California, and that LATD itself was organized under the laws of California and has its principal place of business in that State. The exemption is automatic, when the facts conform to the law.

The case of *Hillsborough Investment Co. v. S. E. C.*, 276 F. 2d 665, cited by S. E. C., is clearly distinguishable on the facts from the instant case. There the issuer discontinued interstate distribution and commenced intrastate distribution of *the same issue*. The trust deed offered by LATD after August 1, 1959, had never before been offered and were *other and separate issues*.

(2) LATD, TD&ME and TD&MM Each Contend That They Would Also Be Exempted by Virtue of the Provisions of Section 4(1) of the Securities Act of 1933 (15 U. S. C. 77(d)(1)). LATD and TD&MM Claim the Exemption That They Have Never Made Any Public Offering and Are Entitled to the Dealer's Exemption. TD&ME Claims the Same Exemption and Also That It Is Neither an Issuer, Underwriter or Dealer.

Section 4(1) of the Securities Act of 1933 reads in part as follows:

"The provisions of section 5 shall not apply to any of the following transactions:

(1) Transactions by any person other tha an issuer, underwriter, or dealer; *transactions b an issuer not involving any public offering*; or tans-actions by a dealer . . .".

The uncontradicted testimony of the executive of cers of LATD and TD & MM is that no trust deed has ver been offered to more than three persons. [R. T. p. 1234.] If such a trust deed is rejected by three pe ons to whom it may be offered, it is then liquidated ad is not again offered for sale. This has always bee the policy and practice of these companies. TD & ME does not deal with the public; is neither an issuer, uder-writer, or dealer, and has never made any public fer-ing. [R. Tr. p. 1236.]

**(3) Persons Dealing in Single Trust Deeds and Mortages Are Exempted From Registration.**

At page 16 of our opening brief, we have quoted Rule 17 CFR 240. 15a-1 of the regulations adopted b the SEC under the 1934 act. The uncontradicted acts with reference to the operations of the appellants, ring those operations squarely within this exemption.

**(4) The Provisions of Section 15a of the 1934 Act (the Alleged Violation of Which Is Charged in Cou t V of Plaintiff's Complaint) Exempts From Regist tion Offerings Exclusively Intrastate and Exempte Securities.**

Commencing on page 16, item (4) of our op ing brief, we have quoted the provisions of this st ute. There should be no doubt of the immediate availabil y of this exemption to the appellants on the basis of th evi-dence that their business is exclusively intrastate and that the trust deed which they sell are exempted rom registration.

Appellants contemplate that they may ultimately desire to resume business in selling trust deeds, and to offer none of the helpful services which this Court has determined converts a non-security, a trust deed, into an investment contract. In this eventuality the appellants, under the wording of this Court's opinion, would first be compelled to register with the SEC and could claim none of the exemptions to which the law would otherwise entitle them.

## XVI.

## Has the Court Considered That Its Opinion Approving the Appointment of the Receiver May Be Contrary to the Ruling of the Supreme Court in Gordon v. Washington?

We respectfully suggest that this Court may wish to reconsider and to clarify a sentence commencing at the bottom of page 29 of its opinion. At this point the Court has considered *Porter v. Warner Holding Co.*, 328 U. S. 395, and *Mitchell v. DeMario Jewelry Co.*, 361 U. S. 288, and with reference to them concludes that they are not directly in point. Then the opinion reads:

> "Nevertheless, we conclude there exists under the latter acts the power and authority in the SEC to bring this action, and power in the district court, as a court of equity, to appoint a receiver to maintain in status quo the assets of the appellants and the respective purchasers of the second trust deeds until such time as the appellants can comply with the law, or dissatisfied trust deed holders or other creditors may take the necessary steps to prove by regular and ordinary methods that the several appellants are insolvent and/or unable to meet their obligations."

We assume the Court will agree with us, that a the SEC had the affirmative of the issue, the burde of proof was on it to establish the jurisdiction and ıces-sity for the appointment of a receiver. Where, w ask, is the evidence upon which the receivership is based

Was it because of the claim insolvency of the a pel-lants? On page 31, middle page, this Court obs ves that "The trial court has found insolvency in the ink-ruptcy sense."

The appellants contend that the only evidence to sup-port this finding may be found in an operation vich the SEC investigators performed on the financial ate-ment of LATD for March 15, 1959, and that the tter and last financial statement of September 25, 959 showed LATD to be in a healthy solvent condition. Ap-pellants' Record p. 194.]

This Court announces no conclusion with respt to solvency.

Was the receivership approved on the basis of th al-leged fraud of the appellants?

We do not understand that this court bases its rling upon that ground.

Was there a plain showing of some threatened loss or injury which only a receivership would avoid?

This court does not say so.

If we understand the paragraph from page 29 vich we have quoted above, the purpose of the appointment was

> (1) "to maintain in status quo the assets o the appellants and the respective purchasers of the sec-ond trust deeds . . ."

(2) ". . . until the appellants can comply with the law"

(3) ". . . or . . . creditors . . . may . . . prove . . . the several appellants are insolvent."

'e respectfully assert it is the function of the injunc-:o specifically authorized by Congress, to maintain in *stqis quo* the business of the appellants until they can coiply with the law, and that there is no evidence or rea-soi to believe there were customers or creditors who wee ready, able or willing to attempt to prove that the apellants were insolvent.

'e suggest that the grounds in this case fall far sht of the standard set forth by the Supreme Court in *'ordon v. Washington,* 259 U. S. 30, where at page 37: declared:

"There is no occasion for a court of equity to appoint a receiver of property, of which it is asked to make no further disposition."

"A federal court of equity will not appoint a receiver where the appointment is not ancillary to some final relief which is appropriate for equity to give."

t page 39 the Supreme Court also said:

"Even when the bill of complaint states a cause of action in equity, the summary remedy by receivership, with the attendant burdensome expense, should be resorted to only on a plain showing of some threatened loss or injury which the receivership would avoid.

## XVII.

### "The Adjudication Against the Appellants Was Made Before the Trial Began . . ."

This was the point which we attempted to make on page 55 of our opening brief. We have quoted above the first part of the heading which appears there. We would like to emphasize the second word "adjudication."

This Court is talking about something else on page 23, lower of middle page, when it declares:

> "Identity of language between what a litigant claims prior to trial and what the court finds as a fact after trial is no proof whatsoever that the trial judge pre-judged the facts, or had made any decision prior to the completion of all testimony and the closing of the case."

The SEC brief admits on page 92, line 6, that there was a "striking parallel between the facts as asserted by the Commission" and the final adjudication of the case.

The important fact is that the trial court, by granting the SEC motion, adopted as its own the facts to be recited. The motion, granted by the Court was, "that the facts herein recited shall be taken as established." [Appellee's Record, Item 6, p. 152, line 12.]

## XVIII.

### Arbitrary Orders Made on the Whim or Caprice of a Trial Judge, Without Pleadings, or Without Evidence, Should Not Be Sustained on Appeal.

The opinion of this Court on page 21, under paragraph (f), does not involve the issue which we sought to make in our brief. The errors of the trial court were much more serious than the failure to give the appel-

; the prescribed notices of hearings and motions, us as we consider that practice to have been. We ght commencing on page 48 of our brief, to describe rbitrary orders made on the whim or caprice of the tri judge, in some cases without pleadings, and in r cases without evidence.

will be recalled that the trial did not commence September 15, 1959. Months before, on June 4, 59, the appellants gave notice, under Rule 27 F. R. C. P. of the intention to take the depositions of Charles R. Burr and R. W. Rheinschild on June 11. [R. p. 117.]

n June 9, 1959, the SEC served on the appellants a Motion of Securities & Exchange Commission for Order that Depositions of Charles R. Burr . . . and R. W. Rheinschild . . . Shall Not Be Taken . . ., etc. [R. p. 12.]

o notice of motion was served with respect to the SEC motion, and no affidavits or evidence of any sort were either served on the appellants or presented to the court.

he court announced that it would hear the motion on the following day, June 10, 1959. On June 10th the matter was argued, and in the absence of any evidence, either on behalf of the SEC or the appellants, the motion was granted prohibiting the taking of the depositions. [R. p. 119.]

lso on June 9, 1959, the appellants were served with an SEC motion for an order under Rule 34, requiring the appellants to produce for inspection certain generally described books and records. [R. p. 121.]

the notice of motion, also served at the same time, the date and hour that the matter was to be presented

was left blank. This matter also was ordered to be heard on the following day, June 10, 1959. Both this and the preceding matter were disposed of by the same order. [R. p. 119.]

The appellants had instituted an action in the United States District Court for the District of Columbia for the purpose of having subpoenas issued from that court for the taking of other depositions in the District of Columbia, in connection with this case. A copy of one of those subpoenas may be found in the record at page 88. Notice was given that the depositions would be taken in Washington, D. C. on June 16, 1959.

On June 12, 1959 there was filed in the Los Angeles District Court, *ex parte,* a document labeled, in part, as follows:

> "Motion of Securities and Exchange Commission for Order that Depositions of Philip A. Loomis, Jr., Walter G. Holden, Robert Block, Charles E. Shreve and Robert S. Plotkin Shall Not Be Taken", etc. [R. p. 80.]

No notice of motion was served or used in connection with the foregoing motion. There was no affidavit or evidence of any sort presented by the SEC in support of the proposed motion. In the absence of; any evidence or proof, and in the absence of any prayer or request therefor, the trial judge issued an "Order to Show Cause" [R. p. 78], returnable on June 22, 1959, and also in the absence of any prayer, request or evidence in support thereof, an order staying the depositions, noticed for *June 16, 1959*, until the matter could be heard by the court on *June 22, 1959*. At the hearing on June 22, 1959, no evidence was presented by the SEC, but evi-

e was presented by the appellants. A document en- l "Defendants' Response to Rule and Order to Show se", verified by David Farrell, was submitted in op- ion to the SEC motion [R. p. 89], together with a rting affidavit by counsel for these appellants. [R p. 110.]

nder date of June 23, 1959, disregarding the affi- ts of the appellants, and in the absence of any evi- e to support his order, the trial judge issued an r prohibiting the depositions sought, and directing the subpoenas issued by the United States District rt for the District of Columbia, should be quashed.

hus the depositions of Charles R. Burr and R. W. nschild, both of Los Angeles, the latter being the ipal witness for the SEC in this case, was pre- ed without any reason being assigned; and the sev- depositions sought to be taken in Washington, D. C. e denied in the absence of any proof or of any legal ification for that denial. The statement made by rial court, that the information sought to be elicited the documents which were to be produced in the hington, D. C. depositions were not relevant to the ect matter of the action, is entirely unsupported by ecord, and on the contrary, the affidavits filed by ppellants [R. pp. 89 and 110] as to the information ht from the witnesses, and the documents listed in *subpoenas duces tecum* [R. p. 88], clearly showed ancy and materiality to the issues in the case.

was not a sufficient reason to deny the appellants ight to take these depositions in Washington, D. C. the SEC should not be compelled to disclose that 25 years in the exercise of its quasi-judicial powers,

it had made adjudications contrary to the ruling wich they were seeking in this action.

There is no legal justification to support the arbitrary action of the trial judge in denying the appellants the right to take the depositions locally of Charles R. Burr and R. W. Rheinschild, and in denying the appellants the right to take depositions of certain SEC employees in Washington, D. C. Each of such persons, being officers, investigators and agents of the SEC might be presumed to have information relevant and material to the case. If the appellants believed that this information might be helpful to their defense, they had a right to find out by asking pertinent questions. The propriety of the questions which might be asked could be determined during the depositions.

The only legal authority cited in the course of the argument, with reference to these depositions, was Rule 122 of the Securities Act of 1933 and Rule X-4 of the Securities Exchange Act of 1934, the former of which is known as 17 CFR 230. 122.

These rules provide that information or documents obtained by officers or employees of the SEC *"in the course of any examination or investigation pursuant to Section 8(e) or Section 20(a)* shall, unless made a matter of public record, be deemed to be confidential.

The rule further provides that SEC employees are prohibited from making such confidential information available unless the Commission shall authorize such disclosure. The rule further provides that any SEC employee served with a subpoena shall promptly advise the SEC of the service of the subpoena, the nature of the information or document sought and any circumstance

hin may bear upon the desirability of making avail-
le such information or document.

I does not appear that the information or documents
ou nt by these depositions was obtained by examina-
on or investigation under Sections 8(e) or 20(a) of
he Securities Act. The subpoenas and the affidavits
le by the appellants [R. pp. 89-110] show much which
ot side of this limitation. One of the defenses raised
r e SEC to the taking of these depositions was that
n of the information sought was a matter of public
ec d in the files of the SEC. This is no reason why
uc information should not be identified and produced
r eposition.

There is no evidence before the court that any of the
E employees whose depositions were sought to be
ke advised the Commission of the subpoenas or the
atu e of the information or documents sought, or of
ny circumstances which might bear upon the desira-
lit of making the information available, or that the
or nission took any action either authorizing or deny-
ng isclosure of the information or documents sought.
he Supreme Court of the U. S., and the other federal
ou s, have consistently reversed judgments rendered
r he Government, in both criminal and civil cases.
he the Government had been favored on pre-trial
isc very, and where discovery rights of the Govern-
ent's adversary had been denied or curtailed. Lead-
ng ases in the Supreme Court are *Goldman v. United*
*ta s*, 316 U. S. 129; *United States v. Reynolds*, 345
U. 1; *Roviaro v. United States*, 353 U. S. 53; and
*nd s v. U. S.*, 353 U. S. 657. Possibly the leading
isc from the circuit courts would be the decision of
he econd circuit, the case of *N. L. R. B. v. Adhesive*

*Products Corp.*, 258 F. 2d 403, where there is a sc larly review of the law on this point.

That by reason of the foregoing, the appellants reby petition the Court for a rehearing.

That because of the novelty of the question pre-sented, the importance as affecting the nation-wide unc-tioning of the Securities & Exchange Commissic, the thousands of persons who will be affected, ar the millions of dollars involved in the case, it is respe fully suggested that it may be appropriate that the cas may be heard on rehearing by the Court en banc.

That in the event this Court shall determine t e pe-tition for a rehearing shall be denied, it is req sted that the mandate of the court may not be issued o the trial court for a period of 30 days to permit an a plica-tion to be made to the Supreme Court for a wit of certiorari, as authorized by 28 USC 2101(f).

Respectfully submitted,

MORGAN CUTHBERTSON,

*Attorney for Appellants and Petitio rs.*

## Certificate of Counsel.

As counsel for the petitioners, I certify that n my judgment this petition for a rehearing has merit nd is well founded, and that it is not interposed for dela.

MORGAN CUTHBERTSON.

## Appendix I.

[Rp. Tr. p. 2808.]

Mr. Kennamer: And also, your Honor, pursuant to agreement, the Commission offers in evidence a schedule which has heretofore been marked for identification as Plaintiff's Exhibit No. 77, a schedule of sales to investors by Los Angeles Trust Deed & Mortgage Exchange ("LATD") of forty-three (43) notes secured by deeds of trust—Tract 3068 (Newport Riviera I and II), Newport Beach, California—purchased by LATD on April 1, 1959, and of repurchases by LATD of such notes from investors during October, 1959, after notice on September 29, 1959, of escrow established with Newport Balboa Savings and Loan Association under which such notes were to be satisfied in full in advance of maturity, showing profit to LATD on original sales to investors, and secret profit to LATD on subsequent repurchases from investors.

In this connection, your Honor, the Commission offers this schedule, subject to the understanding that if in any extent, and this includes, your Honor, the rather elaborate, general explanatory footnotes, if in any extent it is inconsistent with the original records of Los Angeles Trust Deed & Mortgage Exchange, it may be considered modified.

Mr. Foley: Well, your Honor, I think that is correct. I particularly for the record want to call attention to the fact that there is an apparent inconsistency, in that in vertical column 3 on page 1 thereof it shows cost to LATD a figure which does not include the commission paid as reflected by a document which ap-

pears by photostatic reproduction on the sub quent page, and we intend to show the precise amou.

The Court: All right.

Mr. Kennamer: Your Honor, in that connec on, it is the Commission's understanding and conten on at this moment, based upon the records which hav been made available by Los Angeles Trust Deed & M tgage Exchange, that the gross cost of these 43 tru deed notes to Los Angeles Trust Deed & Mortgage Ex nange is as shown in vertical column No. 3. We n y, of course, be in error, your Honor, but we have cons ucted the schedule based upon the records which hav been made available, and if we are incorrect, we ask and I asked counsel yesterday to bring in the record f disbursements relating to this.

The Court: All right.

Mr. Cuthbertson: I would like to object n the ground that the document is irrelevant and imm terial, and does not prove or disprove any issues in th case, and particularly I do not join in the stipulation w h reference to the conclusions that are shown in the ca tions. There is an introductory paragraph among whic there is such language as this, and I quote: "After notice on September 29, 1959, of escrow established wit Newport Balboa Savings and Loan Association under which such notes were to be satisfied in full in adva ce of maturity," and I stop there to make this comment The evidence received in this case is contradictory t that. There is no evidence that the trust deeds were to be satisfied in full in advance of maturity. The e dence was that a letter went out to that effect but it as in error, and for that reason, there was no arran ement

the notes were to be satisfied in full in advance of urity.

nd I also object to the following which I quote again rn the caption of this document in the introductory agraph of this document, and I continue the quota-: "showing profit to LATD on original sales to stors, and secret profit to LATD on subsequent re-chases from investors." I submit that the evidence s not show any such secret profit, but, on the con-ry, shows that there was no profit to the LATD on the transactions.

Ir. Foley: Your Honor, may I be heard, before you ru on that:

think, your Honor, that the stipulation which we ca make and which I intended to make went to the figures themselves and not to the characterization.

he Court: That is true. Mr. Kennamer concedes h.

Ir. Foley: The Commission's descriptions are mis-ea ing.

Ir. Kennamer: To make it explicit, your Honor, o he extent that even the characterizations which we ma le, which appear in the schedule, are inconsistent w i the testimony in the record or with whatever evi-lence the defendants may bring forward from the orig-n records of Los Angeles Trust Deed & Mortgage E hange, the Commission agrees that the schedule may be modified accordingly."

## Appendix II.

[Rep. Tr. p. 1656.]

By Mr. Cuthbertson:

Q. Mrs. Grant, in connection with the account of Mr. Warkow involving trust deed No. 7868, did Mr. Warkow suffer any loss in connection with the transaction to which you testified?

A. No, Mr. Cuthbertson, he wouldn't have suffered a loss.

Q. Did Mr. Warkow receive a full 10 per cent earnings on the money in connection with those transactions?

A. Yes, sir, he would have received full 10 per cent earnings.

Q. In connection with the letter which has previously been called to your attention in connection with these several accounts, involving these 43 trust deeds, I believe it was your testimony that the letter which you received from the Newport Balboa Savings and Loan Association stating that there would be a pay-off was in error. Would you explain what occurred there so that the error, if there was one, would be evident from what transpired?

A. The first loan was held by Newport Balboa Savings and Loan and they were in various amounts, $11,200 to $11,400. These loans were to be taken off of the record, the properties were to be refinanced and new mortgages put on as first loans.

Q. When did you learn that to be a fact?

A. I don't recall the exact date, Mr. Cuthbertson.

. Did you learn that information before or after you received the letter which indicated that there was going to be a pay-off of the second trust deeds?

. Before, before that.

. Then, at the time that you caused the documents, the notes and the trust deeds to be forwarded to the Balboa Savings and Loan Association, did you know at that time whether or not there was going to be a pay-off of those trust deeds?

.. We knew at that time that there was not to be a pay-off, Mr. Cuthbertson.

. And has the Los Angeles Trust Deed & Mortgage Exchange as yet received any cash or any money on the pay-off of any of these 43 trust deeds?

.. The entire package of documents that they had received were returned to us with their letter stating that they were not to be paid off in full and the escrow had been canceled, and this was sometime in November, since that they had held all of the instruments and then finally returned them acknowledging that they had no funds and that there was to be no pay-off and the escrow was canceled.